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El Salvador Strategy Flash

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El Salvador's 12m- accumulated fiscal position came in at -2.4% of GDP in March, while the primary balance clocked in at +1.5% of GDP, posting a significant deterioration relative to February. The fiscal deficit ended 2023 at -2.3% of GDP, 0.6pp wide relative to Dec-22 levels. However, since the start of the year, the fiscal position has fluctuated significantly, at first compressing by 0.3pp, before giving back all of the gained ground in March, as the consolidated position clocked in at -2.4% of GDP, -0.1pp below Dec-23 figures, and marking a -0.4pp widening relative to February. During March income sources compressed by -0.2pp, a decrease which compounded with a significant rise in outlays, which experienced a steep hike during the aforementioned month, being engrossed by +0.2pp. The widening in expenditure comes after a +1.1pp hike in Dec-23, which responded to the administration's political needs and continues to deteriorate fiscal fundamentals. In this context, NFPS income totaled 24.5pp of GDP in March (-0.2pp vs. February). The variation in the segment was mostly explained by a lone -0.2pp drop in tax revenues. The rest of the segments remained flat relative to their Feb-24 figures. This slightly shuffled the composition of Income sources. Therefore, Tax revenues came in at 19.7% of GDP, accounting for 80.2% of Total Income, in line with February's figures.

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Outlays totaled 26.9pp of GDP in March, spiking by +0.2pp relative to February. The increase in expenditure was mainly driven by the Consumption segment, even if weaker Interest payments managed to partially offset the surge. Current outlays clocked in at 22.9pp of GDP, rising by +0.2pp relative to February. In turn, inside the segment, the widening came on the back of an +0.3pp increase in Consumption of Goods and Services, which was partially offset by a -0.1pp drop in interest payments, which capped the hike in expenditures. The rest of the lines remained plateaued relative to Feb-23. After a sizable increase in Capex expenditure in December, which saw it balloon by nearly +28.6%mom (+1pp of GDP), the segment lost significant momentum, with figures flatlining in January, and remaining plateaued in March. The segment now stands at 4pp of GDP, with gross investment accounting for 3.6pp of GDP. With primary NFPS Income falling by -0.2pp and primary NFPS expenditures rising by +0.3pp of GDP, the primary surplus weakened significantly relative to February. Still, the balance continues to stand at a relatively healthy +1.5% of GDP level, well inside positive territory, albeit it was severely dented by the administration's deployment of fiscal stimuli in December, and now by the deterioration of fiscal figures.

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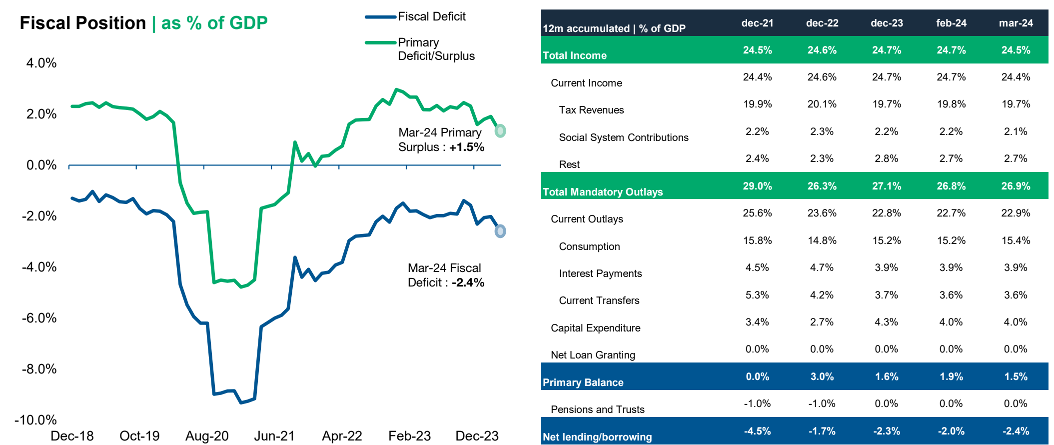
Even if the administration managed to run a tight ship in its last tenure, with its fiscal bias remaining significantly hawkish, the recent return to international markets burdens fiscal figures with some additional stakes. Up until December, the administration showcased conservative management of public finances, maintaining a wide primary surplus, responding to both the administration's character and the lack of funding sources faced by the Salvadoran Government. However, with the elections on its front door, the administration decided to put the pedal to the metal regarding fiscal stimuli, increasing capex by nearly 1pp of GDP during December. Even if we did not believe such slippage to be necessary, as the administration enjoyed sky-high popularity ratings due to security improvements, it seems to have bore some fruit, as Mr. Bukele was reelected with 84.7% of the vote, and secured 54 seats out of 60 (90%) in the legislative assembly, maintaining undisputed policy continuity until at least the next legislative elections, which will take place three years from now, in 2027. However, with the election cycle out of the way, the administration decided to launch an LMO with the purpose of clearing short-term maturities with a tender offer, raising additional funding sources, and regaining access to international markets. Looking at both phases of the LMO, it is clear that it was successful in

clearing the short-term payment schedule of the Eurobond curve, albeit paying a high financing cost for additional funding, which compounds with a steeper payment profile, which is now heavily loaded in the 2028-2030 period. However, the return to international markets also included an interest-only, macro-linked security (for more information, please click here, here, and here), which steps up if the country fails to enter an IMF program or obtain a B- credit rating, before 18 months. In our view, the trail of fiscal figures this year will depend on which of the two paths the administration wants to take to not pay additional interest. If the alternative of choice is signing a deal with the IMF, then some fiscal slippage is to be expected, as the administration is finally not as cash-strapped due to the issuance and has some room to spend before entering the IMF program, which will surely require a return to fiscal discipline, and will provide further financial aid, turning a tight fiscal bias in the present unnecessary. Instead, obtaining a B- credit rating implies maintaining a very hawkish fiscal position, as fundamentals need to improve further to obtain said rating. In this scenario, the recent slippage of fiscal figures suggests that the administration is confident in signing an IMF deal in the following months, as it can showcase the government's expectation of receiving further financing from the Fund, which would allow for a more lax fiscal policy in the coming months.

Figure 1: March's fiscal figures



12m accumulated | % of GDP	dec-21	dec-22	dec-23	feb-24	mar-24
Total Income	**24.5%**	**24.6%**	**24.7%**	**24.7%**	**24.5%**
Current Income	24.4%	24.6%	24.7%	24.7%	24.4%
Tax Revenues	19.9%	20.1%	19.7%	19.8%	19.7%
Social System Contributions	2.2%	2.3%	2.2%	2.2%	2.1%
Rest	2.4%	2.3%	2.8%	2.7%	2.7%
Total Mandatory Outlays	**29.0%**	**26.3%**	**27.1%**	**26.8%**	**26.9%**
Current Outlays	25.6%	23.6%	22.8%	22.7%	22.9%
Consumption	15.8%	14.8%	15.2%	15.2%	15.4%
Interest Payments	4.5%	4.7%	3.9%	3.9%	3.9%
Current Transfers	5.3%	4.2%	3.7%	3.6%	3.6%
Capital Expenditure	3.4%	2.7%	4.3%	4.0%	4.0%
Net Loan Granting	0.0%	0.0%	0.0%	0.0%	0.0%
Primary Balance	**0.0%**	**3.0%**	**1.6%**	**1.9%**	**1.5%**
Pensions and Trusts	-1.0%	-1.0%	0.0%	0.0%	0.0%
Net lending/borrowing	**-4.5%**	**-1.7%**	**-2.3%**	**-2.0%**	**-2.4%**

Source: TPCG Research based on BCR

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